

# FRAUD AND ITS RELATION TO THE HOSPITALITY INDUSTRY

by  
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## ABSTRACT

NICOLE JANELL ROSS: Fraud and its Relation to the Hospitality Industry  
(Under the direction of Dr. Victoria Dickinson)

The purpose of this study is to analyze and explore the numerous components of fraud, including its relation and presence in the hospitality industry. Additionally, the study contains findings and analyses derived from participation in a professional development series conducted in a classroom setting and two accounting case studies hosted by PricewaterhouseCoopers and KMPG in Fall 2013. I will dissect fraud down to its various elements and compile a work plan and proposal originating from the findings from the study. The study examines the causes of fraud, people who commit fraud, fraud legislation, and fraud trends. Through primary and secondary research, I was able to determine fraud is a rapidly evolving problem present in all parts of the world; however, it is possible to combat fraud and its perpetrators by being conscious, informed, involved, and proactive.

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## LIST OF ABBREVIATIONS

ACFE	Association of Certified Fraud Examiners
AHLA	American Hotel & Lodging Association
CEO	chief executive officer
CFE	certified fraud examiner
CFO	chief financial officer
FTC	Federal Trade Commission
IP	intellectual property
ISHC	International Society of Hospitality Consultants
PCAOB	Public Company Accounting Oversight Board
PwC	PricewaterhouseCoopers
SOX	Sarbanes-Oxley

## 1) Introduction

Fraud is defined as, “a false representation of a matter of fact—whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed—that deceives and is intended to deceive another so that the individual will act upon it to her or his legal injury” (“Fraud.”). Fraud has been occurring for many years and can be dated back as far as the colonial era (Singleton). Early incidences of fraud involved land schemes and moved to corporate fraud with the creation of corporations in the seventeenth century (Singleton). This paper focuses on two types of fraud—internal and external. Throughout this paper, it is imperative to note that all of the research is based on reported fraud. Many cases of fraudulent behavior are handled personally and never reported to a higher authority.

## 2) Fraud Triangle

The big question is, “why do people even commit fraud?” Years of research have resulted in an answer illustrated by what is known as the fraud triangle. The fraud triangle demonstrates the three key reasons people engage in fraudulent behavior. The first section of the triangle is pressure. Pressure is the original motivator in almost all fraudulent behavior. Pressure can arise from financial needs, gambling issue, drug addition, earnings goals, business targets, and desire for more (promotion, new car, new house, and etcetera). The next section is opportunity which describes the perception of how the fraud can be executed. The potential fraudster sees a way he can use his position in the workplace to solve the pressures he is facing. Furthermore, he also believes there is little to no chance of being caught, as long as, he keeps the fraud a covert. The third section is rationalization which is when the fraudster convinces himself the fraudulent act is acceptable or justifiable. Rationalizations include, but are not limited to the following: 1) I had to do it for my family, 2) My superiors are dishonest, and 3) I am not paid adequately.



# The Fraud Triangle



Figure 1

### 3) Types of Fraud

#### i) Occupational Fraud

Fraud is an extremely broad word. Occupational fraud is often referred to as internal fraud, and the terms are used interchangeably. An example of internal fraud is when an employee of a business is skimming cash from the cash register. There is also external fraud in which the perpetrator is not involved in the operations of the company. The Association of Certified Fraud Examiners (ACFE) issued a global study called, *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*. The survey will be referred to multiple times throughout the paper. Despite previously providing information based solely on the United States, the ACFE global study is much more relevant because a vast majority of businesses have transformed and incorporated global transactions. Additionally, fraud is becoming more of a global issue. According to survey participants, an estimated five percent of revenues are lost each year due to fraud, and the median loss from each incidence is approximately \$140,000. Occupational fraud is categorized into three main sections: corruption, asset misappropriation, and financial statement fraud.

## Occupational Fraud Categories

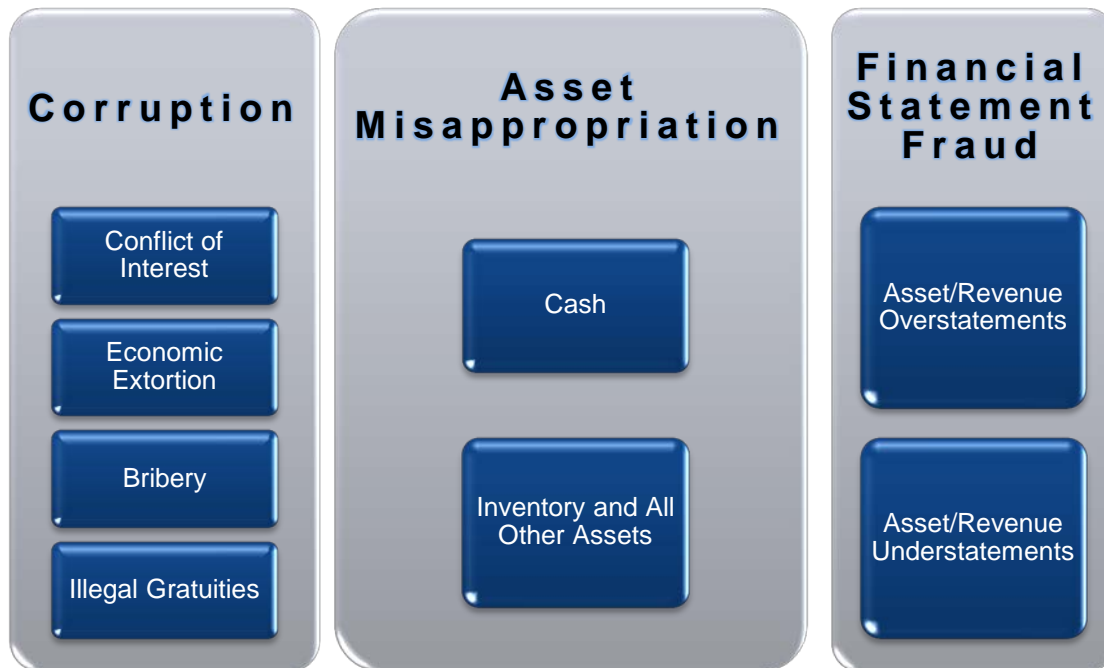


Figure 2: Association of Certified Fraud Examiner's Fraud Tree

Based on the report, the ACFE concluded corruption occurs in approximately one-third of reported fraud cases and has a median loss of \$250,000. Corruption is defined as, "any scheme in which a person uses his or her influence in a business transaction to obtain an unauthorized benefit contrary to that person's duty to his or her employer" (Gerber). Corruption is committed by four schemes: conflicts of interest, bribery, illegal gratuities, and economic extortion ("Fraud Tree."). The ACFE report found asset misappropriation is the most common type of fraud encompassing 87 percent reported cases and the least costly with a median loss of \$120,000. Asset misappropriation can be extremely diverse in nature; therefore, asset misappropriation is generally broken down into eleven categories: skimming, cash larceny, billing, expense

reimbursements, check tampering, payroll, cash register disbursements, misappropriation of cash on hand, and non-cash misappropriations (*Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, 3). Broadly speaking, asset misappropriation is the taking of assets, and it is accomplished by the various methods previously listed. Furthermore, the ACFE's report concluded financial statement fraud only makes up about eight percent of reported cases; however, the median loss is the greatest among the types at \$1 million. Financial statement fraud is the "falsification of an organization's financial statements to make it appear more or less profitable" (Gerber). Statements are falsified through asset and revenue understatement and overstatement ("Fraud Tree.").

Occupational fraud is not industry specific and can occur in any type of legally structured business (Gerber). Corruption, misappropriation of assets, and financial statement fraud can occur in any industry at any time. However, there are trends associated with occupational fraud. According to the *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, industries most frequently victimized were the banking and financial services, government and public administration, and manufacturing divisions. Also, small businesses are at greatest risk and suffer the largest losses due to less employees and anti-fraud controls (*Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, 3).

The hospitality industry is equally susceptible to fraud as any other industry. Unfortunately, the hospitality industry experiences high levels of fraud.

“Among the leading reasons that hospitality companies are exposed to high levels of fraud is that the industry's culture tends to focus much more on providing great customer service than on the internal financial controls that go into running a hotel, resort or restaurant” (Goldmann). The idea of focusing on customer satisfaction seems ideal; however, focusing too much on one aspect of business often causes a shortfall in other areas. “According to Robert W. Rudloff, Jr., vice president of internal audit at MGM Mirage in Las Vegas, when line employees, supervisors, managers and senior executives are focused so narrowly on getting customers to come back, internal financial controls inevitably get short-changed” (Goldmann). According to PwC's *2014 Global Economic Crime Survey*, 78 percent of hospitality and leisure survey participants experienced asset misappropriation. The hospitality industry is unique in nature when it comes to fraud. When internal controls are inferior, like other industries, employees often misappropriate assets, executives often give in to corruptive behavior, and top management is induced to submit fraudulent financial statements. A common example of asset misappropriation in the hospitality industry is theft of food and beverages. The internal control to prevent this particular misappropriation is proper inventory check and supervision of employees. A common example of corruption in the hospitality industry deals with hotel comps and bribery. A prominent hotel guests will bribe top management with direct compensation in order to receive a special rate on premium hotel rooms. Additionally, financial statement fraud is evident in the hospitality industry by management manipulating financials in order to reach

earning goals for the quarter. When internal fraud is present, it is common for external fraud to have a presence or potential to. The primary types of external fraud experienced by hotels are credit card and identity fraud. “The challenge is to achieve balance. Balance between the quest for premium customer service and the unavoidable necessity to keep hard-earned revenues from flowing out through exploitation of inadequate internal controls” (Goldmann).

## Fraud Cycle

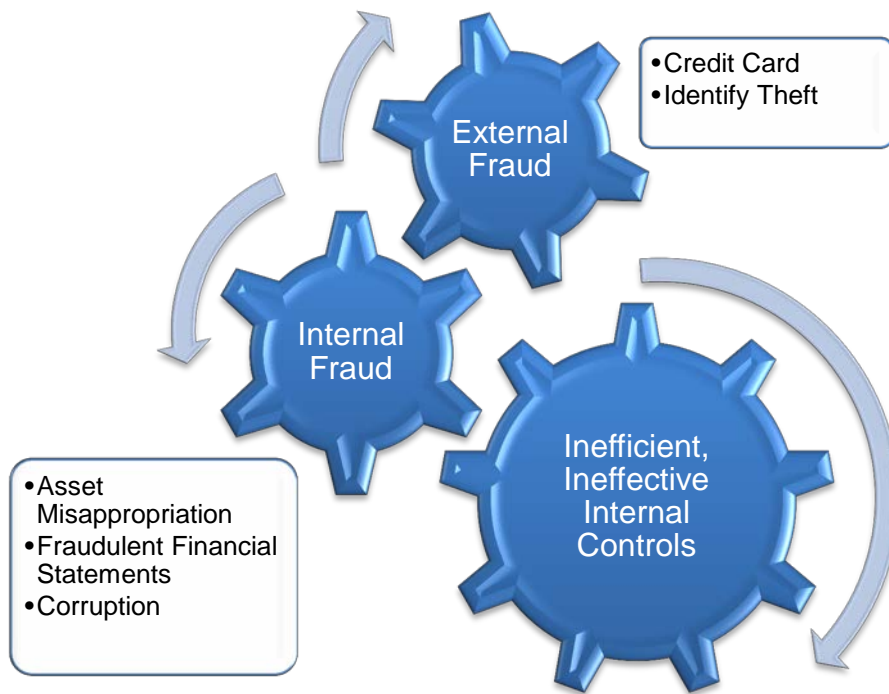


Figure 3

## ii) External Fraud

External fraud, particularly credit card and identity theft, is becoming an increasingly significant issue for the hospitality industry. While hospitality executives are focusing on making hotel guests satisfied with their stay, security controls are suffering. Credit card and identity theft go hand in hand regarding hospitality fraud. Externals see a deficiency in a hotel's network filled with confidential information and attempt to breach the network. Sometimes, externals are even tipped in by internals who witness the business' internal weaknesses first hand. When fraudsters or criminals see an opportunity to hack a system worth millions, they tend to take the opportunity. In recent news, from March to December 2013, 14 hotels managed by White Lodging, experienced a data breach exposing guests' credit and debit card information (Sutton). It is exceedingly vital the hospitality industry keeps a close eye on confidential information to avoid losing its guest's trusts and revenue.

#### 4) Typical Fraudster

The word fraudster has been used multiple times throughout this paper; however, it is may be very hard to visually imagine who a fraudster might be. There are many questions about fraudsters regarding gender, age, and ethnicity. In 2011, KPMG issued *Who is the Typical Fraudster*, which includes the characteristics of a typical fraudster.

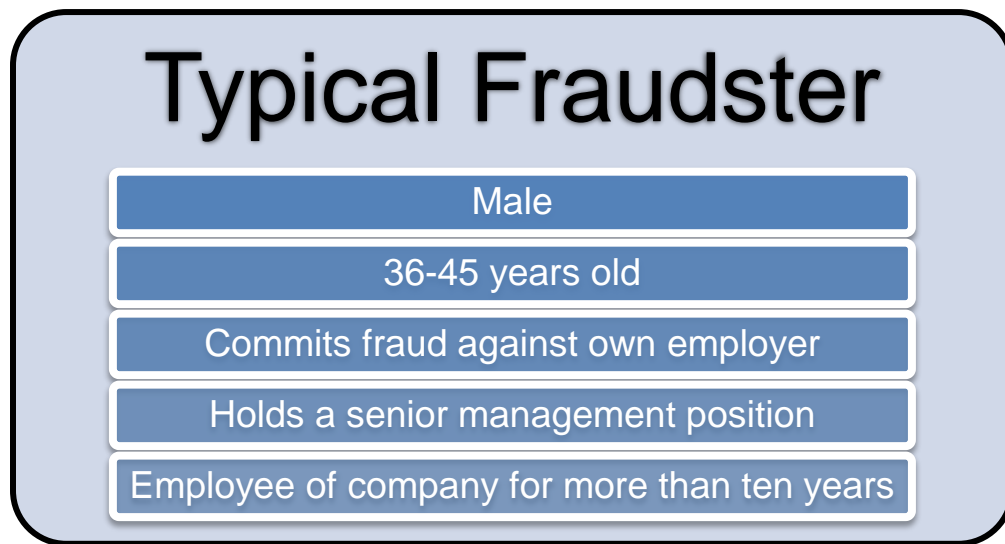


Figure 4: KPMG – *Who is the Typical Fraudster*

Additionally, the ACFE's *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study* provided information on the typical fraudster. According to the ACFE's report, more than three-quarters of fraudsters belonged to one of the following six departments: accounting (22 percent), operations (17.4 percent), sales (12.8 percent), executive/upper management (11.9 percent), customer service (6.9 percent) or purchasing (6.7 percent). Also, regarding perpetrators' highest level of education, 36.9 percent had a college degree, 25.3 percent high school diploma or less, 20.5 percent some college, and 16.9



percent postgraduate degree. The report also concluded 87.3 percent of perpetrators had a clear criminal background, and 83.7 percent of perpetrators had never been punished or terminated in the work-field. Although, it may seem as if fraudsters are hard to identify, the ACFE recognized multiple behavioral red flags for potential and actual fraudsters.

## Behavioral Red Flags

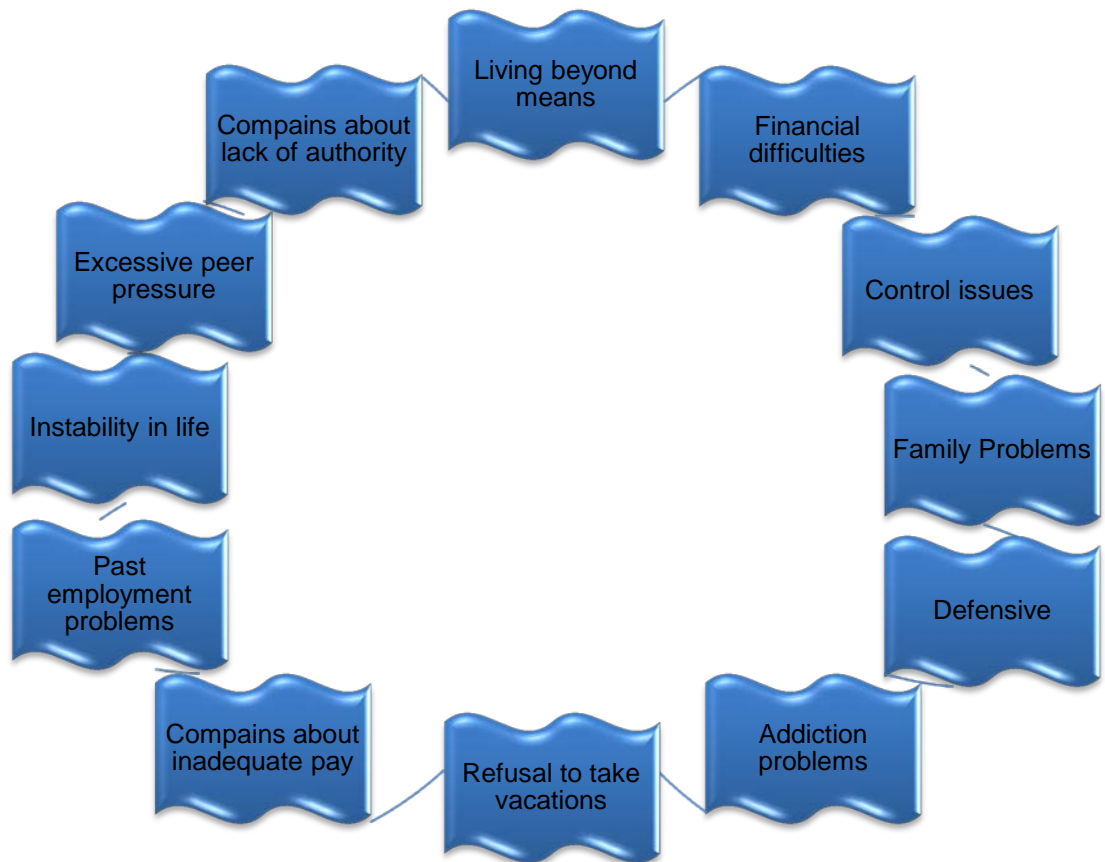


Figure 5: ACFE's *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*

## 5) Laws/Internal Controls/Ethical Codes

### i) Internal Controls

Companies have the potential to reduce fraud by designing and implementing an internal control system. In 2002, Sarbanes-Oxley (SOX) was enacted. Section 404 of Sarbanes Oxley requires all public companies in the United States “to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting ... The registered accounting firm shall, in the same report, attest to and report on the assessment on the effectiveness of the internal control structure and procedures for financial reporting” (“Sarbanes-Oxley Act Section 404”). Even though SOX only applies to public companies, private companies are encouraged to have internal control systems. The two main components of an internal control system are effectiveness and efficiency. The control system must be effective in the sense that the internal controls are being enforced and regulated. For a control system to be efficient, it must be working in the proper manner. Thus, the single most important aspect to internal controls after design is to enforce the system. Many companies have an internal control system in place, but fail to ensure the internal control system is being enforced and obeyed. The ACFE completed a study in the *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study* and identified the difference internal controls can make.

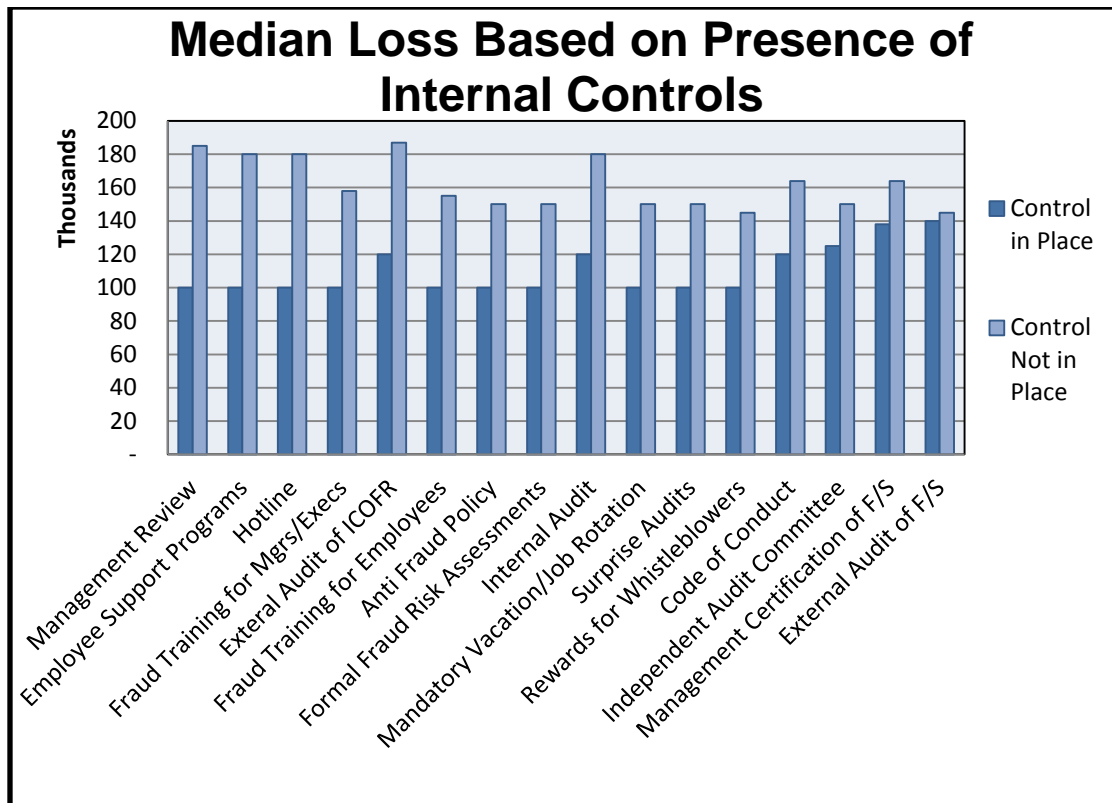


Figure 6: *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*

As illustrated by the graph, on average, there is a difference of \$830,000 in losses for having internal controls present versus not having internal controls present. Having internal controls present can save a company millions, possibly billions, over its lifetime. When internal controls are effective and efficient, they are ideally reducing fraud, increasing financial reporting reliability, and complying with laws and codes simultaneously.

## ii) Laws and Ethical Codes

Furthermore, there are laws (external force) and ethical codes of behavior (internal force) used to combat fraud. “Laws against fraud vary from state to state, and can be criminal or civil in nature. Criminal fraud requires criminal intent on the part of the perpetrator, and is punishable by fines or imprisonment. Civil

fraud, on the other hand, applies more broadly to circumstances where bad-faith is usually involved, and where the penalties are meant to punish the perpetrator and put the victim back in the same position before the fraud took place” (“Fraud – FL.”). Additionally, certain fraud cases, such as tax evasion, can constitute a federal crime. U.S. Code Chapter 47 – Fraud and False Statements covers the federal regulations regarding fraud (“18 U.S. Code Chapter 47 - FRAUD AND FALSE STATEMENTS”). The punishment for federal fraud crimes are based off federal sentencing guidelines. The guidelines consider a number of characteristics about the crime including loss amount (“reasonably foreseeable loss”), number of victims, and fraudster’s position (“How Do the Federal Sentencing Guidelines Work in Fraud Cases?”). Convicted fraudsters are often punished with jail time, restitution, and fines.

Certain industries and business have ethical codes of conduct. Specifically, the International Society of Hospitality Consultants (ISHC) has a code of conduct in place for all of its members. The code puts an emphasis on professional attitude and behavior, relationships with clients, and professional relationships (“ISHC Code of Conduct”). Ethical codes of conduct serve as an establishment of the presence of a demand and expectance of ethical behavior in a work place. It puts an emphasis on the core values of a company and what is expected from all members.

A major issue with fraud laws and ethical codes of conduct is the rising prominence of global fraud. Global fraud is becoming extremely popular, especially in the area of cyber fraud. The laws and ethical codes in the United

States cannot be used against global fraudsters. Therefore, legislation and codes used to combat fraud are not as effective in preventing fraud. For example, the recent Target credit card breach is allegedly linked to Russian fraudsters. Even if Target was able to pin point the perpetrators, laws against data breaches and fraud could not be used in a foreign country.

## 6) Cyber Fraud

A new door has opened for fraudsters attempting to compromise confidential information. The new door is cyber fraud. Cyber fraud is also known as internet fraud, and it is when fraudsters engage in fraudulent activity through computers and internet connections. For accounting purposes, the main issue with cyber fraud is the hacking of identities and financial information. “When most people think of identity theft, they picture their wallet getting stolen and someone using their driver’s license and credit cards. However, with the internet becoming increasingly important in our everyday lives, identity theft has moved online and into our computers and smart phone” (“Cyber Fraud”). When hackers gain access to computers and smart phones, retaining financial information is a piece of cake. Also, intellectual property (IP) can be compromised through cyber fraud. “IP theft is a leading cause of economic losses today. Whether it is other organizations trying to steal information, or hackers who are politically-motivated, this threat affects not only individuals, but organization’s revenue levels and the Nation’s economic growth and sustainability. There is evidence that shows massive transfers of wealth-generating innovations to rivals domestically and abroad, resulting in serious consequences for advanced economies for decades to come” (“Cyber Fraud”). The constant conversion to becoming more technologically advanced by increased use of smart phones and computers for nearly all activities demands careful attention. The increase in technology has created an astronomical amount of opportunities for cyber fraudsters.

The current laws and legislation regarding cyber fraud are outdated (McConnell). However, the Obama administration is pushing for tougher laws to impede the increasing numbers of cyber fraud cases (Leger). Cyber fraud is accelerating in terms of occurrence because of the lack of updated laws. "Federal Trade Commission Commissioner Edith Ramirez testified that the FTC wants a strong federal data security and breach notification law, although most states have laws, a 'strong and consistent national requirement would simplify compliance by business while ensuring that all consumers are protected,' she said" (Leger). Ramirez also said, "Never has the need for legislation been greater with reports of data breaches on the rise, and with a significant number of Americans suffering from identity theft, Congress needs to act" (Leger).

Recently, the American Hotel & Lodging Association (AHLA) joined a merchant, financial services association in cybersecurity partnership ("AH&LA Joins Merchant, Financial Services Associations in Cybersecurity Partnership"). "The partnership will focus on exploring paths to increased information sharing, better card security technology, and maintaining the trust of customers" ("AH&LA Joins Merchant, Financial Services Associations in Cybersecurity Partnership"). Katherine Lugar, president and CEO of the AHLA, said "The U.S. hotel industry is committed to protecting the confidential data of our customers. We look forward to working with merchant and financial groups to advance measures to further enhance data security" ("AH&LA Joins Merchant, Financial Services Associations in Cybersecurity Partnership"). The hospitality industry as a whole is taking the necessary precautions to protect itself and its customers from cyber

fraud while legislation is attempting to conform to the global and advanced technology era.

Unfortunately, the hospitality industry is a target for cyber fraud because of the vast amount of confidential and financial information retained. “Hotels are obvious targets for identity and financial theft for many reasons. Hotels transact business through credit cards, and those credit cards are kept on file and can be accessed multiple times during a guest's stay ... Every charge is another opportunity for an identity thief to access the information using sophisticated computer hacks and other malicious software, generally without the hotel's knowledge” (Braun). Additionally, “The Identity Theft Resource Center noted, ‘the ability to connect to the Internet is an integral part of many individual's daily life. This has led to the increased demand for public WiFi.’ As a result, hotels find themselves compelled to offer wireless internet, and that service is almost always unsecured. But an unsecured wireless network is just as dangerous as leaving files of your most important personal documents on a street curb for all to see. Hackers can easily get into an unsecured wireless network and get financial information, business records or sensitive e-mails” (Braun). This is another example of issues the hospitality industry has between enforcing effective and efficient controls and satisfying guests. The following are basic initiatives the hospitality industry can take to prevent cyber fraud (Braun).



# Cyber Fraud Prevention Initiatives

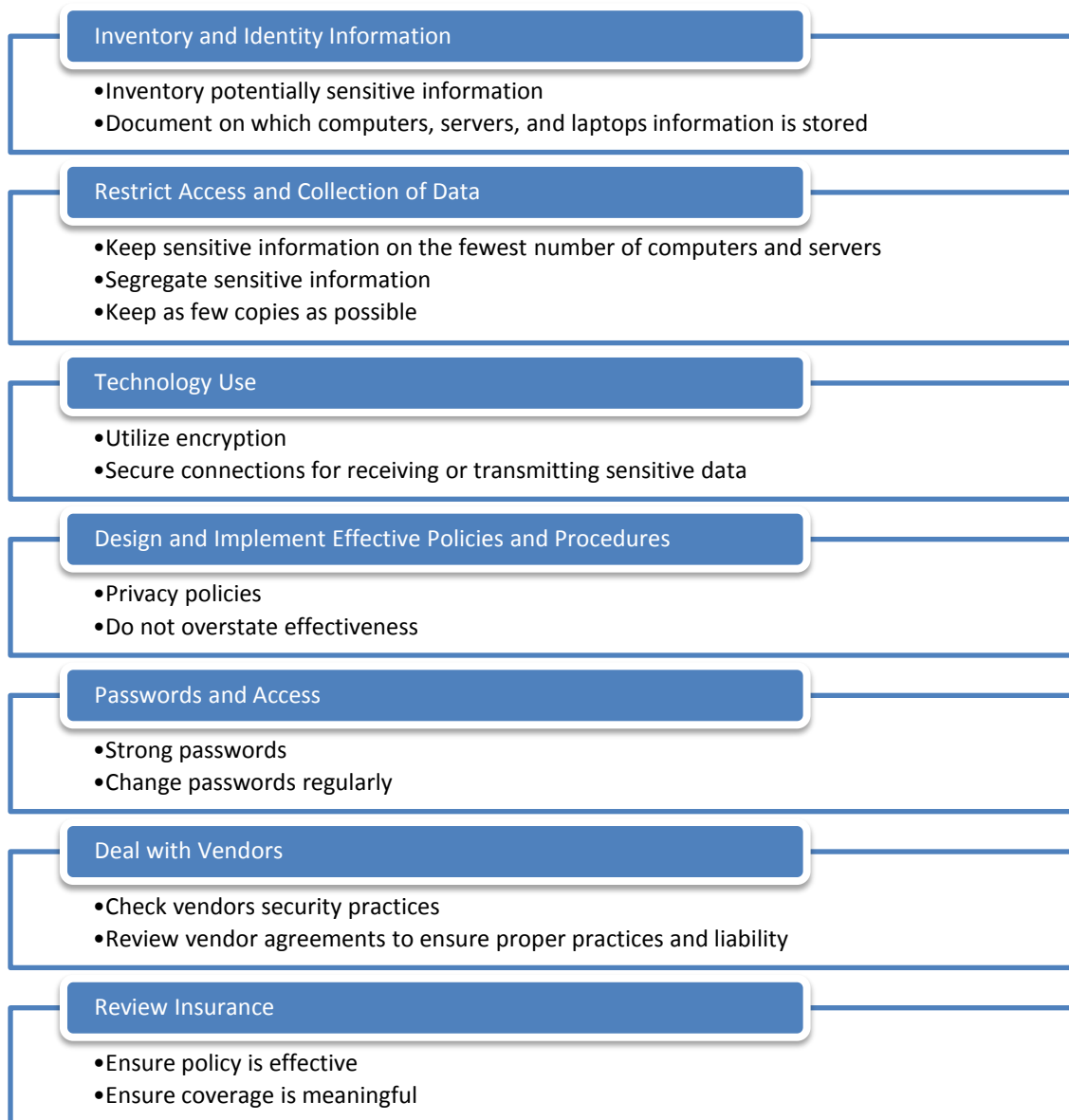


Figure 7: Braun

## 7) Trends

### i) Fraud Occurrence

Fraud has been on a sporadic slope for many years. Prior to Sarbanes-Oxley, fraud incidences were increasing. After Sarbanes-Oxley was enacted, fraud incidences decreased. In 2008, fraud began increasing again due to the failing economy. When the economy is restored, it is reasonable to predict fraud will decrease.

### ii) Economy

There is a direct correlation between the economy and fraud. In March 2009, the Association of Certified Fraud Examiners (ACFE) randomly distributed a survey to 6,000 Certified Fraud Examiners (CFEs) in the United States. Through the surveys, the ACFE concluded the level of fraud has increased since the economic downfall. Additionally, the ACFE concluded the increase in fraud resulted from an increase in pressure faced by a vast amount of individuals. The individuals tend to be employees which caused an increase in employee embezzlement. Of the 507 surveys used to compile the data, 70 percent believed the incidence of employee theft would continue to rise in the coming year. ACFE's core finding is more than 80 percent of respondents expressed belief there is more fraud during times of economic distress.

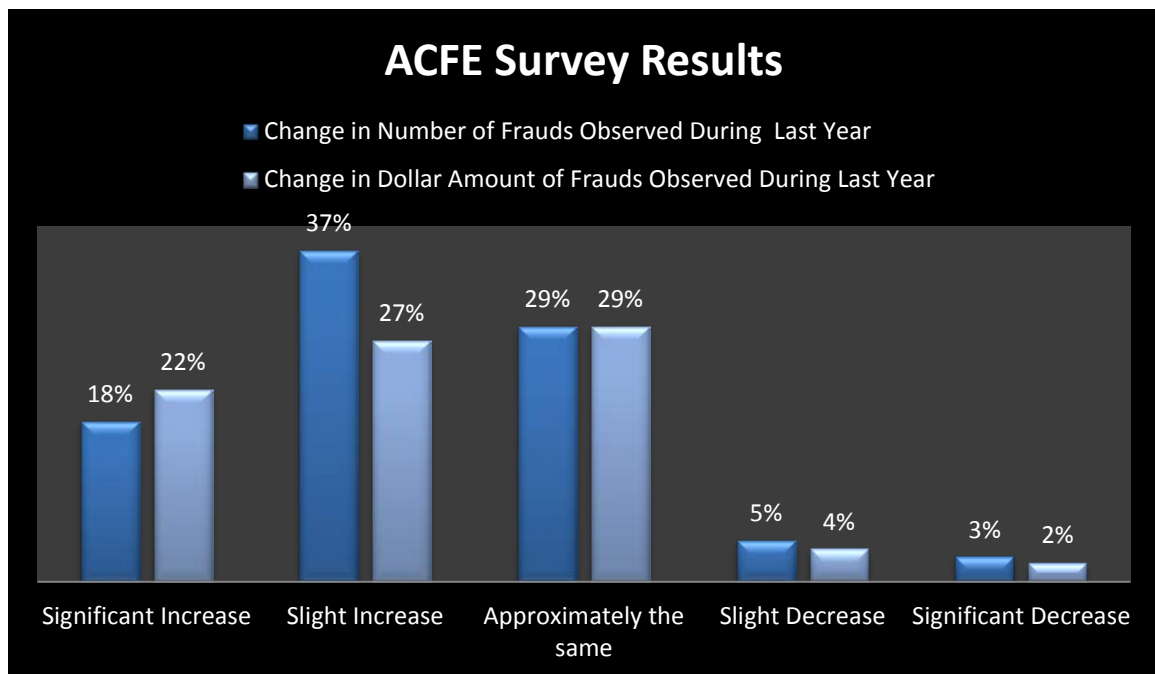


Figure 8: Occupational Fraud: A Study of the Impact of an Economic Recession

### iii) Media

The media has played an astronomical role in the revealing of information regarding prevalent accounting fraud cases in the nation. Particularly, the media kept a close eye on the Enron and Madoff scandal. The cases came to the public's eye through a medial portrayal. The media continued with the cases by informing the public of the company's reaction and legal consequences faced by the fraudsters and victims. Every detail of the trials involving Enron and Madoff were covered by the media from the beginning and to the end. Despite the ending of the trials, the media continues to inform the public of any information in these cases and any new cases. The most important aspect of the media in regards to accounting fraud is the fact the media puts a heavy emphasis on the consequences and losses occurring in fraud cases. The media presents to the

general public which includes individuals who are or will be CEOs, CFOs, executive management, member of board of directors, internal auditors, or potential fraudsters. Emphasizing the consequences the fraudsters face acts as a deterrent. Additionally, bringing the large amounts of losses to light encourages business people to pay closer attention to internal controls and signs of fraud. The downfall to media's involvement in accounting fraud is the limitation of coverage. Typically, the media is only interested in large scandals involving an astronomical amount of money. Because of this, many fraudsters still engage in fraudulent activity with the mindset that small amounts will not be a big deal.

## 8) Opportunities Related to Fraud Investigations

The accounting practice related to fraud investigations is generally referred to as forensic, litigation support and valuation services (Glenn). The overwhelming majority of fraud engagements are consultative in nature and do not offer an opinion of any kind (Glenn). Accountants typically assist clients in pointing out potential areas of loss, quantifying potential losses, and quantifying/identifying actual losses (Glenn). The typical fees associated with such an engagement are generally in the lower five thousand ranges and are very rarely discounted due to rapidly approaching cliental (Glenn). With the advent of technology, many employers now issue employees laptops, cellphones, and personal email accounts. During fraud investigations, employees' work related items will often be searched for signs or clues about fraudulent behavior. Also, employers provide employees with multiple computer programs on their laptops.

"Big data" refers to the large amount of information stored as one file or within a single location. Since many companies contain big data, when a breach occurs, there is a much larger risk for loss. Additionally, when on a fraud investigation or a consultation, accountants have to rummage through large amounts of information. Luckily, with the advent of technology various programs have been created to help with analyzing big data. There are programs that are able to filter out transactions. Filters can be useful in finding large, unusual, or consecutive transactions. The advent of technology has brought and evolved

many models of fraud investigation techniques, and it is reasonable to predict the methods will continue being created and evolved.

## 9) Undetected fraud

Based on the *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, the ACFE concluded occupational frauds reported lasted a median of 18 months before being detected. There are multiple methods of initial detection of occupational fraud.

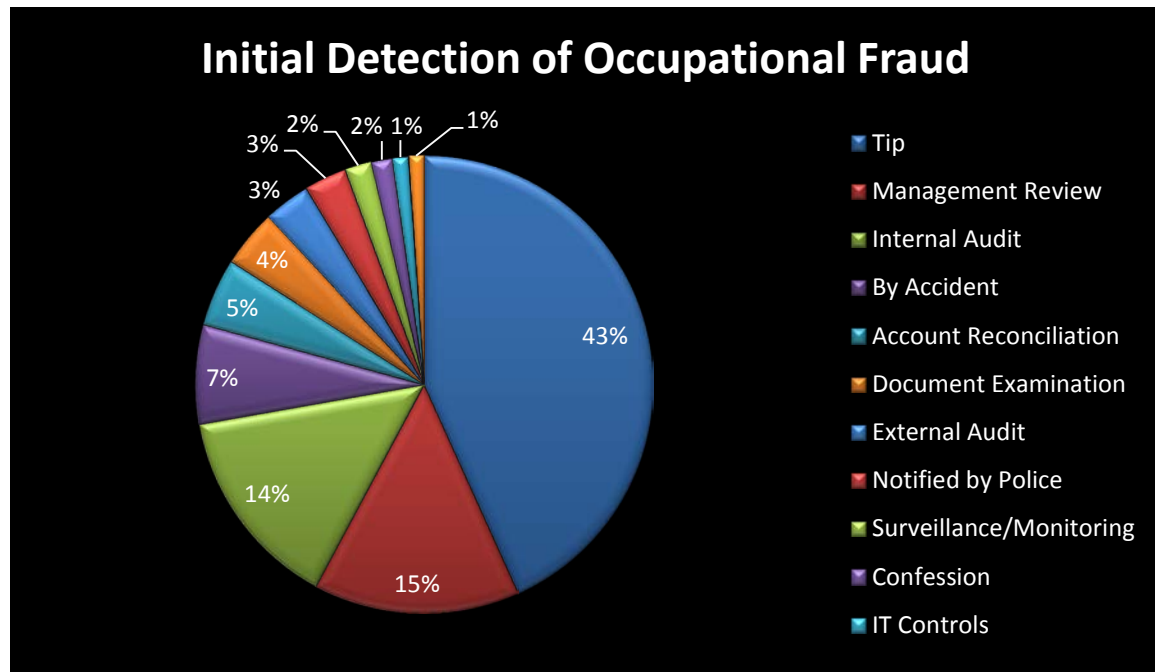


Figure 9: *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*

When a company is a victim of undetected fraud for a significant period of time, the financial losses are increased versus if the fraud would have been detected at an earlier time. Significant financial losses often lead to a company's failure (Thompson). Furthermore, when there is a presence of fraud, financial statements will have to be reissued, have a prior period adjustment, or possibly be audited by the Public Company Accounting Oversight Board (PCAOB). Additionally, taxable income could have been reported incorrectly when the company was victim of fraud; therefore, tax returns may have to be amended to

correct the amount of tax paid in. The public perception ramifications depend on the amount of loss and publicity it receives. If a company lost large amount of money and is publicized as a failing company, it is likely the public will view the company as a failure. When a company does not have a good public perception, it is likely to cease.



## 10) Work Plan

The following work plan was created with insight from the *2014 Fraud Examiners Manual* published by the ACFE. Accounting firm ABC received a phone call from a client XYZ about suspicions of fraud. The manager of XYZ has noticed inventory in the dining area of the hotel has been diminishing much quicker than usual and not matching up with sales reports. Manager of XYZ asked firm ABC to conduct a fraud investigation. Now, ABC has to create an engagement letter, obtain signatures, and plan a fraud investigation. The objective of the investigation is to “resolve allegations or signs of fraud when the full facts are unknown or unclear” (*2014 Fraud Examiners Manual*). ABC fraud investigation team is going to “obtain facts and evidence to help establish what happened, identify the responsible party, and provide recommendations where applicable” (*2014 Fraud Examiners Manual*). With these objectives in mind, ABC will staff the engagement based on XYZ’s needs and type of suspected fraud. ABC’s team will include a certified fraud examiner, audit manager, data analysis specialist, legal counsel, and forensic accountant all with expertise in hospitality industry fraud and asset misappropriation. In planning the fraud investigation, ABC’s fraud team will determine the overall goal of the investigation. Due to the lack of known facts, ABC will begin their investigation with general information and then move to more specific details. The first step to the investigation is to analyze available data. ABC will conduct interviews with neutral third parties, parties suspected of involvement, and the actual suspected parties respectively. ABC will analyze dining room transactions and respective inventory counts. After

analyzing all available data, ABC should create a “worst-case scenario” hypothesis. Next, ABC will test the hypothesis with multiple “what-if” scenarios, new information, and integrating known information. After an in depth investigation, ABC’s fraud investigation team will come to a conclusion. Based off the conclusion, ABC will report to XYZ its findings and give recommendations.

# Fraud Investigation Work Plan Overview

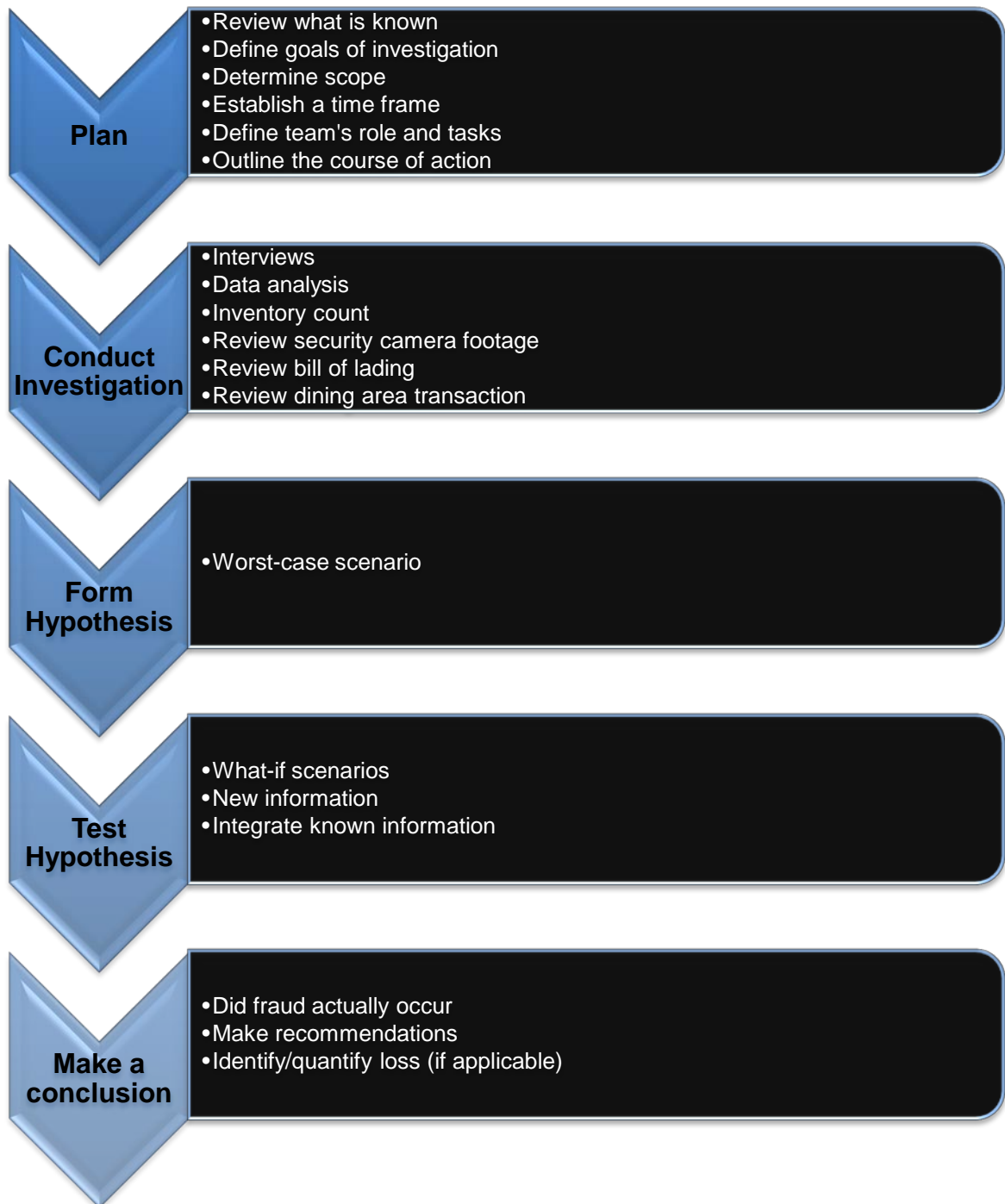


Figure 10

## 11) Proposal

Accounting firm ABC is preparing a proposal to a potential hospitality client XYZ. The proposal is focusing on preventing inventory, particularly food and liquor, theft and mitigating losses due to fraud. ABC will be focusing on its ability to assist XYZ in compliance, updating systems, and assessing risks. As the ABC business advisor, I will stress the importance of a fraud prevention system specifically for food and liquor inventory with qualitative and quantitative support. According to the *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, the median loss for asset misappropriation is \$120,000 a year. We would charge the client \$15,000 a year for a five year contract to implement the fraud prevention program and keep the program up to date with routine check-ups. Furthermore, over the five year span the potential client is likely to lose around \$600,000 without a fraud prevention program. With our program, the client has the opportunity to pay 12.5 percent of the potential \$600,000 to prevent the large losses. Additionally, our fraud prevention program will increase revenues while reducing operating costs. Revenues will increase due to the decrease in food and liquor theft while operating costs are decreasing due to no longer needing to reorder inventory as frequently compared to when food and liquor was being stolen.

Our proposed fraud prevention plan includes internal controls, inventory checks, computer generated reports, security camera installation, fraud awareness education and training, fraud hotline, and background checks for employees. Our focus on internal controls is to make sure there is an effective

and efficient system working within the dining area of the hotel. We also suggest routine inventory checks. Regular inventory checks will serve as a “check-list” and deterrent. With proper, routine inventory checks, XYZ will be able to compare sales and remaining inventory. Based on the comparison XYZ will clearly be able to see the profit they are making based on food and liquor inventory. Furthermore, our fraud prevention program involves implementing computer generated reports comparing inventory counts, sales, and disposals. Reports will allow a thorough comparison and check figure for management. To enhance XYZ’s personal fraud prevention program, we would assist in installing security cameras in the dining areas. Security cameras would be installed in the inventory room, kitchen, bars, and particularly toward the cash registers. Cameras by the cash register will reveal if any employee is cashing in fake coupons or skimming the drawer. Fraud awareness education and training has proved to be very effective in the work place. When employees are aware their employer is taking proper precautions to detect fraud, employees are often deterred from committing fraud against their employer. Not every employee would be deterred by inventory checks, security cameras, or fraud education; therefore, we would implement a fraud hotline. The fraud hotline would be extremely beneficial in detecting fraud being that research shows the top initial detection of fraud was through tips. Lastly, our prevention program entails running background checks on all employees. Background checks are simply a preventative measure to avoid employing people with past history of dishonesty.

We at ABC will be dedicated in assisting XYZ in all measures of the fraud prevention program. In the case your company alters its operating size, we will ensure your fraud prevention program is the perfect match for your operations at the time. We will also ensure and explain the fraud prevention program to any interested stakeholders. Our number one goal is preventing fraud and satisfying our clients.

## 12) Unintended Consequences

Unfortunately, it is very common to have negative consequences from implementing antifraud initiatives. Often times, the consequences are unexpected and unintended. Therefore, when companies are designing their antifraud initiatives, it is imperative to consider all possible consequences—good and bad. For example, a company may implement a rigorous inventory check to be conducted daily. As a result, the manager will be spending too much time on the inventory check resulting in a deficiency in another possible area of fraud. It is extremely important for companies to find the perfect medium regarding antifraud policies.

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## APPENDIX A



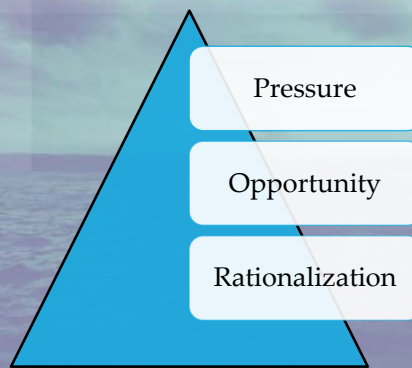
### Agenda

- Overview of fraud
- Types of fraud
- Fraud in the hospitality industry
- Typical Fraudster
- Internal Controls/Laws
- Cyber fraud
- Work Plan
- Proposal
- Unintended Consequences

## What is Fraud?

- Fraud is defined as, “a false representation of a matter of fact that deceives and is intended to deceive another so that the individual will act upon it to her or his legal injury.”

## Fraud Triangle



## Types of Fraud

- Occupational/Internal
- External Fraud
- Cyber Fraud

## Occupational Fraud

### Corruption

- Conflict of Interest
- Economic Extortion
- Bribery
- Illegal Gratuities

### Asset Misappropriation

- Cash
- Inventory and All Other Assets

### Financial Statement Fraud

- Asset/Revenue Overstatements
- Asset/Revenue Understatements

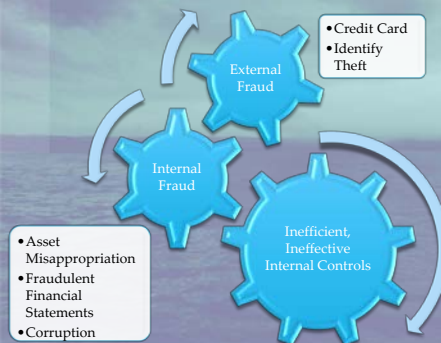
## External Fraud

- ⦿ Financial fraud
  - Credit card
  - Debit card
  - Bank account information
- ⦿ Identity theft
  - Social security number
  - Driver's license number

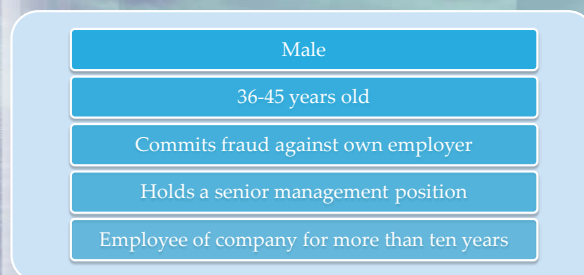
## Fraud in the Hospitality Industry

- ⦿ “Among the leading reasons that hospitality companies are exposed to high levels of fraud is that the industry's culture tends to focus much more on providing great customer service than on the internal financial controls that go into running a hotel, resort or restaurant.” – Peter Goldmann

## Fraud Cycle



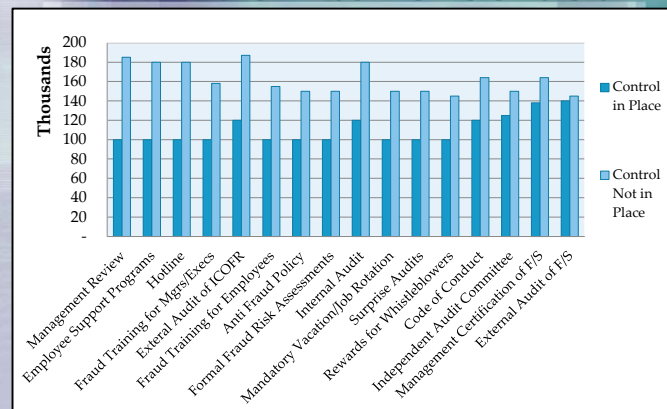
## Typical Fraudster



## Behavioral Red Flags

- ⦿ Living beyond means
- ⦿ Financial difficulties
- ⦿ Control issues
- ⦿ Defensive
- ⦿ Addiction problems
- ⦿ Refusal to take vacations
- ⦿ Complains about inadequate pay
- ⦿ Past employment problems

## Median Loss Based on Presence of Internal Controls





## Laws

- ⦿ Fraud crimes can be civil or criminal
- ⦿ Federal and state laws
- ⦿ Punishments vary state to state
- ⦿ Fraud is becoming a global issue

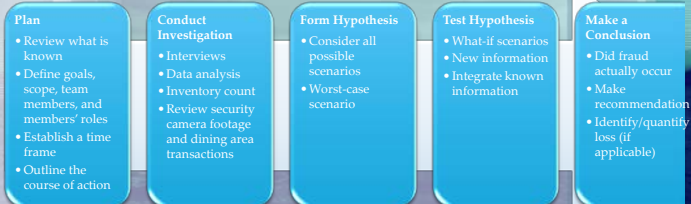
## Cyber Fraud

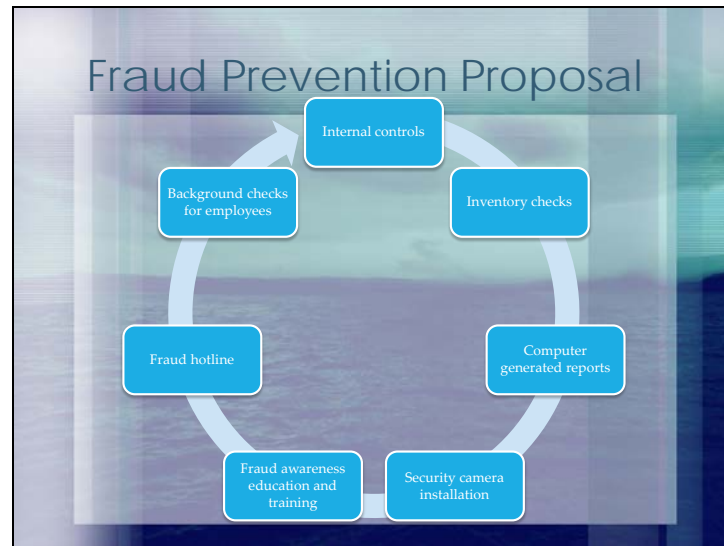
- ⦿ Increasing issue due to advance of technology
- ⦿ Global issue
- ⦿ Hospitality industry is a target because of vast amounts of stored confidential information
- ⦿ Unsecured wireless connections are a big risk

## Cyber Fraud Prevention Initiatives

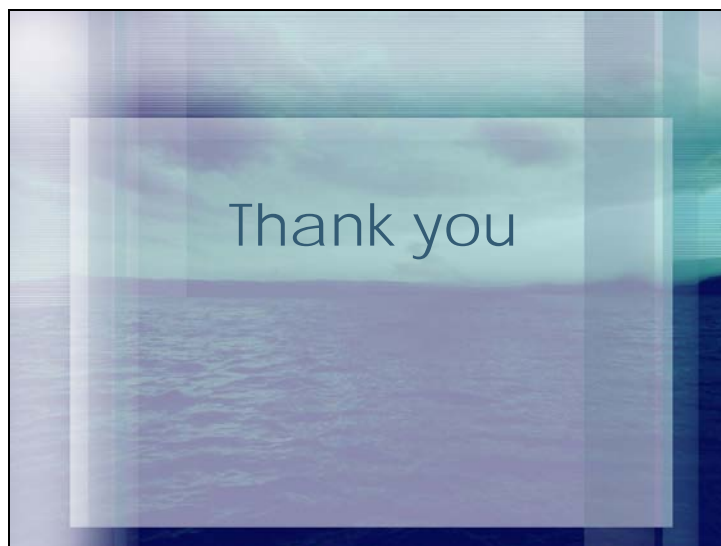
- ▶ Inventory potentially sensitive information
- ▶ Keep sensitive information on the fewest number of computers and servers
- ▶ Segregate sensitive information
- ▶ Utilize encryption
- ▶ Secure connections for receiving or transmitting sensitive data
- ▶ Strong passwords
- ▶ Change passwords regularly

## Work Plan





- ## Unintended Consequences
- Antifraud initiatives can have negative unintended consequences
  - Must consider all possible outcomes of initiatives
  - The key is to find balance



APPENDIX B

# Professional Development and Speaker Series

Nicole Ross

This portfolio is a summary of the cases and competitions compiled during Fall 2013  
in conjunction with ACCY 420.

# Professional Development and Speaker Series

*PricewaterhouseCoopers, September 12, 2013*

- Ken Verheeck-Partner, Assurance Houston, TX
- Brent Ellis-Managing Director, Tax Houston, TX
- George Bordelon-Experienced Associate, Assurance Dallas, TX
- Corey Edgar-Campus Sourcing Dallas, TX

## Summary of the case

The town of Westmead was faced with a gas tax dilemma. Because of the rapid evolution of alternative energy cars, the gas tax revenue dramatically declined which caused a shortage in the budget. The particular area that suffered was the upkeep of the roads. Roads needed to be redone, but there was not any money to do so.

## Our solution

We, Jenny Trout and I, came up with a solution to decrease the tax credits associated with alternative energy cars. This particular town offered a credit for buying an alternative energy car and for using one. People who bought these cars were already benefitting without the tax credit because of fuel efficiency.

## What I learned

I learned that the particular problem we were presented is actually a very common problem. The case began with a simple letter basically pleading for help, and the firm was left up to researching data and coming up with multiple solutions. I also learned, when trying to reach a solution to such a problem, I have to think of every possible effect of each possible solution.

## Summary and Highlights

...

Chris Glenn's, risk advisory leader at Dixon Hughes Goodman, presentation on fraud sparked a further interest in the fraud segment of accounting. I plan to use his teachings and my learning from the case in my career as a, auditor and eventually as a certified fraud examiner. The presence of fraud in the world despite the various methodologies to prevent it intrigues me. I intend to delve further into fraud and how to prevent it.

## *BKD, September 19, 2013*

- Linda Trifone - Senior Manager, Audit  
Jackson, MS
- Matt Glover - Senior, Audit  
Jackson, MS
- Thad Burke - Senior, Tax  
Jackson, MS
- Chandler Croom - Staff, Audit  
Jackson, MS

### Summary of the case

Joanne Rodrigues, an officer manager at a termite and pest control business, embezzled nearly one million dollars from Aloha Termite and Pest Control. She was a very close friend of the company's family and trusted personally, whole-heartedly by Shawn Murray, the owner of Aloha Termite and Pest Control. Rodrigues stole the money over a period of three and a half years. Rodrigues was sentenced to one year in prison, placed on five years of probation, and ordered to pay restitution for the money she had stolen over the 3 and a half year time period. The question was, "Could this fraud have been prevented, or caught in the early stages? Explain your reasoning."

### Our solution

There were several red flags regarding the fraud including excessive control and a known gambling problem. If the red flags would have been identified early, Rodrigues may have not stolen the large amount of money. Mr. Murray was aware of Miss Rodrigues' gambling problem before hiring, and he had consistently noticed her excessive control over the various duties she performed. The owner could have implemented particular procedures, such as budgets and trend analyses, which would have potentially alerted an issue. Additionally, several controls were lacking previous to the fraud committed by Rodrigues. There was not any segregation of duties; Rodrigues completed all of the financial work without review by anyone but herself. Also, the control of mandatory vacation could have been implemented, and the fraud would have been detected earlier. Most importantly, the owner of the company should have completed a background check and called previous employers. After conviction, Mr. Murray called Joanne's previous employer and learned she had also stolen money from him.

### What I learned

The particular case I worked on emphasized the need for internal controls. Without internal controls, a business is likely to encounter difficulties. Even more important than having internal controls is actually implementing the internal controls. Mr. Glover stated many companies that are fraud victims had an internal control

system, but they were not ensuring employees and management were enforcing the system.



## *KPMG, September 26, 2013*

- Kirsten Hill - Managing Director, Advisory  
Dallas, TX
- Betsy Sights – Campus Recruiting  
Memphis, TN

### Summary of the case

We were presented with a very difficult, but thought-provoking case. We were challenged to create a make-believe, but realistic company and decide who the stakeholders would be. We had to identify the internal, external, direct, and indirect stakeholders after creating our company.

### Our solution

This particular case was extremely difficult because of the vagueness; however, the challenging case really made me think. My team created a biodiesel producing company located in North Mississippi. My team tried to look at the possible stakeholders from each level. Through deliberation and critical thinking, we were able to compose stakeholders for each division. Internally, the stakeholders consisted of managers and supervisors. External stakeholders were suppliers of feedstock and vendors. Direct stakeholders were employees because they were affected by the day to day operations. External stakeholders were our customers and end users.

### What I learned

I learned many aspects of key stakeholders, including who they are, their expectations, and how to understand them. It is very vital to a company to have effective stakeholder management. Every company needs integrity, leadership and transparency because they are excellent business drivers. Because of the intricate case, I realized there sometimes can be a limitless list of stakeholders because stakeholders are basically anybody who is impacted by the business. It is a grueling process to determine all the stakeholders for a business. It takes knowledge and full understanding of the company to successfully determine the stakeholders. Until the presentation, I never knew the difference between stockholders and stakeholders, or the impact that stakeholders can have on a business. It is very pertinent to a company to correctly identify potential stakeholders and their possible reactions to business decisions. Through the identification of the accurate stakeholders, companies can make strategic operation decisions that affect the company positively efficiently.

## *Center for Intelligence & Security Studies, October 3, 2013*

- Dr. Carl Jensen – Director of CISS  
University, MS

### Summary of the case

We were presented with a case that consisted of copies of a clandestine drug record. The record was on a random piece of paper with numbers. The paper would have been easily overlooked among a pile of bills. We were also given a decoding problem which was very common in the drug world.

### Our solution

I used my accounting knowledge to “decrypt” the clandestine drug record. I recognized words and symbols that have been present during my accounting class, such as equal signs, discount, balance, and lines representing a total. I looked for words associated with drug terminology that Dr. Jensen taught us during his presentation. The decoding problem was extremely difficult because the code word was in Spanish. After Dr. Jensen helped out and revealed the code word, it was basically a bunch of plugging in numbers. After I plugged in the numbers, I had to do a few simple division problems to identify the drug costs and profit.

### What I learned

I learned drug records are very messy and sometimes, hard to decipher. Drug dealers often record information in very odd spots, including children's books. The papers that are documented with drug records often blend in with other everyday papers. Drug dealers do this in attempt to prevent their records from being found. It was very intriguing to realize how much my accounting knowledge helped solve the cases. Accountants and the information they have obtained from schooling and work is extremely pertinent in putting criminals away in bars. It showed me another possible career path with my accounting degree that could make the world a safer place. Dr. Jensen was a very informative and interesting speaker. He gave a different aspect of the accounting world. Government agencies like the FBI recruit accountants because of their expertise and potential to excel in financial record deciphering. Even though, the cases were difficult, the problem was very easy to figure out once the code was deciphered. Many clandestine drug records are very similar and have one key that sheds light on the entire document. With accounting knowledge and gaining experience in this field, accountants, including the future me, can truly help the world to be a safer place while using a degree and knowledge, not a weapon or forceful, life-risking tactics.

## *Dixon Hughes Goodman, October 10, 2013*

- Chris Glenn - Risk Advisory Services and Internal Audit Practice Leader  
Memphis, TN

### Summary of the case

Mr. Glenn presented us with a case for a computer software company that had been a victim of fraud. The company's human resource department and management had communication problems. After being released from the company, the ex-employees login and building access card stayed activated for months. There was a segregation of duties policy. However, it was not being enforced between the IT and sales department particularly. Additionally, the company did not enforce email controls.

### Our solution

The group I was in pointed out two vital problems: communication problems and lack of enforcing controls. The company could have prevented the fraud if email controls were designed and implemented. The previous employee had openly talked about committing fraud against the company for months through company email. Internal controls should have caught a conversation about fraud. After the fraud was discovered, the previous employee was fired; however, he still had building and login access for a period of two months following his termination. Even though, the previous employee did not commit any further crimes, he certainly had the opportunity to. We suggested that HR and management create a more effective, timely way of deactivating previous employee's access to the building, login, and more importantly, confidential files. Additionally, we recommended monitoring the internal controls more closely to ensure the policies are being implemented effectively and efficiently.

### What I learned

I learned many different variations of fraud. There are fraudulent reporting and misappropriation of assets which can be accomplished through lack of internal controls. The lack of internal controls can be due to a lack in policy or implementation. Mr. Glenn went in to depth about computer and IT fraud. He explained the various ways people can commit fraud through computer and IT. It is absolutely amazing the array of activities available to do through the computer and its technology. A person can manipulate the system to allow the fraud. Additionally, he explained the various ways to prevent fraud. The obvious answer is to design and implement the proper internal controls. Technology is becoming more popular and is advancing at an astronomical rate; therefore, companies need to keep their internal controls up to par with the advancements and popularity of technology.

## *PricewaterhouseCoopers Challenge, October 15, 2013*

### *Team Members:*

- Nicole Ross
- Liz Carroll
- Opeyemi Ajayi
- Charles Rainey
- Tanner West

### *Summary of the case*

Perpetual Energy Co. is planning to build a biodiesel facility in West Texas. The investment is going to cost 8.5 million dollars and take 18 months to build. The plan is still in its infancy; therefore, the company is asking for input. However, the company does plan to pursue the construction of the facility. Perpetual Energy's main focus as a company is long term sustainability; therefore, they are particularly concerned with the biodiesel facility's ability to be a long term, sustainable, and revenue producing asset. It is also important to mention that the current government subsidy for biodiesel facilities is a \$1, but it may see an increase up to \$1.50. They would also like to know the various environmental, financial, and social effects of their plan to build the biodiesel facility.

### *Our solution*

Uptown, our group, suggested three things to Perpetual Energy Group: to use animal fat rather than soy oil as a feedstock, to sell the glycerin (biodiesel by-product), and to expand their market. We suggested using animal fat as a feedstock versus soy oil because it is cheaper and more readily available. Also, animal fat is already being produced and would simply be disposed of if not used. Being in Texas, which is the largest cattle producer in the nation, Perpetual Energy Group would have a more steady supply of a feedstock, be promoting environmentally safe disposal, and create a relationship with the cattle industry. Secondly, we recommended selling glycerin which is a by-product of biodiesel to create an additional source of revenue. Perpetual Energy Group could sell the glycerin to the cattle industry because the cattle industry uses glycerin as a supplement in feed. If our first suggestion was implemented, the sale of glycerin would strengthen relationships. Lastly, we suggested Perpetual Energy Group expand their market to school districts, USPS, and locomotive transportation.

### *What I learned*

The main thing I learned from PwC Challenge is how to work on a realistic accounting issue with a team. It was extremely helpful to get a taste of what companies will expect their accountants to do. Being able to cohesively work as a team and come up with the winning solution was a learning experience as well.

Although having accounting knowledge is pertinent, being able to work with others to come to a solution is something I will be doing nearly every day in my accounting career.

## *Deloitte, October 17, 2013*

- Bradley, Allen  
Memphis, TN
- Michael, Aaron  
Memphis, TN

### Summary of the case

We were presented with various assignments that Certified Public Accountants perform on a daily basis. The assignments were all extremely different, but tied together in a seemingly strange way. We were asked to determine if the assignments were a tax, audit, or advisory service.

### Our solution

I labeled the different assignments as tax, audit and advisory to the best of my knowledge. Particularly, one of the assignments was preparing tax returns for a large company while consulting them what to do in the future to maximize their earning. My first thought was that this was a tax service; however, after careful consideration, I determined this was a tax and advisory service. One team was preparing the tax returns while another team with the same firm was focusing on improving the client's business. After the entire class worked through the case, we began to go over the different assignments listed. The objective of the assignment was not to label each assignment, but to actually realize how whether it is tax, audit or advisory is not always as clear cut as it seems. Out of the assignments, I did not label any wrong; however, I had missed the point there was a conjoining service on a few.

### What I learned

The speakers really helped me grasp the differences and similarities between tax, audit, and advisory. I realized how tax, audit, and advisory can work together despite seeming to be completely different things. Accounting firms have different sections of teams for tax, audit, and advisory; however, this does not mean they are completely separated from each other. Often, the tax team may need the advice of the advisory or audit team and vice versa. The other focus of the presentation was on the various types of advisory work in the field. When meeting with firms, the question is often, "audit or tax?" It was very eye-opening to see the different types of work available besides the typical audit or tax. While, I may be coined as an audit or tax intern, my duties and services provided could range between a variety of service lines. Also, if I was not quite fond of just tax or audit, there are other options out there in the accounting field.

## *Horne, October 24, 2013*

- Parrish, Emily  
Jackson, TN

### Summary of the case

The case was concerning an audit of a bank. During the audit, there are multiple tasks that need to be completed in order to progress through the audit. In the case, Ms. Parrish presented, we honed in on journal entries. The main objective of the case was to determine which journal entries to decide to test out of the hundreds of thousands to choose from.

### Our solution

To figure out which journal entries to test, I had to go through a unique thought process. When, who, what, where, why, and how are the words that were constantly reoccurring in my head. When would a fraudulent journal entry likely be made? Holidays, weekends, and after hours. Who would likely make the fraudulent entry? Disgruntled, financially instable employees. What would the fraudulent entry be labeled as? An odd account. Where might a fraudulent journal entry be listed? Under petty cash. Why would someone write a fraudulent entry? Opportunity. How was it even possible to make the entry? Internal control issues. Through that thought process, I picked out a select group of journal entries to test. I did not manually go through the hundreds of thousands of journal entries. We used accounting software to filter through the journal entries. By using the filters, the journal entries that I thought to be possibly associated with fraud, showed up. I traced the journal entries and was able to come to the conclusion that I could reasonably assure none of the journal entries were fraudulent.

### What I learned

I learned that the process of testing journal entries, particularly for banks, can be a very lengthy process. Although, the audit software filters speed up the process, the thought process cannot be processed through a computer. Sometimes, banks do not maintain their journal entries in simple formats; therefore, as the auditor, I would have to convert all the journal entries into a spreadsheet or similar document in order to use the audit software. Banks typically have about 750,000 journal entries which is why the process can be so lengthy. Computer software can assist and shorten the process, but regardless, critical thinking is involved. I learned the required thought process to determine the entries to test. Additionally, we also learned about Benford's Law which is concerned with a distribution of first digits in a number. Benford's Law has been consistently proven to be true with outliers making appearance due to fixed fees; however, it does not apply to a sequence of numbers or fixed amounts. An illustration of Benford's Law is provided for in the portfolio.

## *Pfizer, October 31, 2013*

- Valerie Hall
- Bradley Baker
- Justin Dill

### Summary of the case

Company XYZ's reports are due May 1 annually and require a CFO or comparable position signature. Company XYZ failed to report an annual liability of \$50,000 for ten years on the annual report. Using the information provided and Tennessee Penalty Calculation Sheet, we were asked to calculate the penalty and interest for XYZ failing to report the \$50,000 annual liability.

### Our solution

Using the Tennessee penalties and interest charge document, I determined the company was liable in the amount of \$815,000. To calculate that amount, I had to determine the look-back period for the liability. The look-back period for the annual liability was five years. Therefore, Company XYZ was liable for 15 years. The annual liability was unreported for 10 years, and I had to look back 5 more years because of look back period laws. If Company XYZ would have had to pay the penalty and interest to Delaware, the period of liability would have been 31 years. XYZ would have had \$1,550,000 of straight liability, \$1,162,500 of civil penalties, and \$1,022,000 of interest totaling for a grand liability of \$3,647,000.

### What I learned

I learned about an entirely new subject that I never even knew existed—abandoned and unclaimed property. It was extremely intriguing because I have never even heard of the subject from an accounting standpoint. When the opening slide appeared, I instantly thought we were going to be discussing abandoned houses and physical properties, such as land. However, I quickly realized that the abandoned and unclaimed property we were discussing were intangibles, such as unclaimed gift certificates, untaken checks, unclaimed rebate programs, etcetera. I learned that the company has the responsibility to report the unclaimed property. If the property is not retained after the dormancy period, certain steps have to be taken to attempt to deliver the unclaimed or abandoned property. If all the proper, legal attempts to deliver fail, the company is required to turn the unclaimed intangibles over to the state the company is located or incorporated. States can make and some are making billions of revenue off abandoned and unclaimed property. Delaware's 3<sup>rd</sup> largest revenue source is abandoned and unclaimed property revenue. I honestly never even thought about what companies would do with unclaimed tangibles, much less think I would ever actually learn what does happen. There are specific guidelines for liabilities and unclaimed and abandoned intangibles for companies to abide by.



## *KPMG International Case Competition, November 4, 2013*

### *Team Members:*

- Nicole Ross
- Nicole Barnes
- Joe Curry
- James Shackelford

### *Summary of the case*

Kraft acquired Cadbury through a hostile takeover in late 2009. Management was not concerned about shareholders during the acquisition, because they were not using equity to finance to loan. After the acquisition, Kraft had failed to meet its growth objectives and debt reduction plans. Cadbury had establishments with various distribution channels globally. We were basically asked, "We acquired this company thinking it was the right move. Now, we acquired even more debt and cannot meet our debt reduction plans. We also are not growing like we expected. What do we do now?"

### *Our solution*

Dynamic Assets, my group, created a three step solution for Kraft. The first part of the solution was to sell Cadbury. We believed Cadbury was an unstable company preventing Kraft from gaining sustainability and growing globally. We came to the conclusion that Cadbury was an unstable company through financial statement analysis. We computed debt and equity ratios of both Cadbury and Kraft before and after the acquisition. After our calculations, Kraft could have sold Cadbury for not much more than it bought it for; therefore, Kraft could recover from its bad decision unscathed. Second, we believed Kraft needed a five year period to recover financially before delving into companies and/or products Kraft was not ready for. Kraft had acquired a different company in 2007 and suffered greatly just as it had with Cadbury; however, Kraft had began improving after the 2007 acquisition, but continued to decline following the Cadbury acquisition. Third, we suggested Kraft create a new product line after the financial recovery period. With the new product line, we also suggested creating an international hunger relief initiative. The results would be reestablishing themselves globally and repairing their North American market.

### *What I learned*

KPMG did not release the case until Friday at 4 p.m. and we presented Monday at 11:45. I learned how to quickly, but efficiently work with other people to come up with a solution. Not only did we have to create a solution, we had to determine how to implement the plan. Case competitions help with teamwork skills. Also, case competitions really helped my presentation skills.

## *Financial Statement Analysis, November 7, 2013*

- Dr. Vicki Dickinson – Assistant Professor  
Oxford, MS

### Summary of the case

We were provided with Kroger's 10K, which included financial statements. We were challenged to do a financial statement analysis of Kroger's latest financials. Using information from the financial statement analysis, we were asked to do an equity valuation. After gathering this information, I would be able to determine if investing in Kroger stock is the right choice.

### Our solution

I began with calculating Return on Equity (ROE) which equaled 36.6%. ROE in itself is useless; it is only useful when compared with something. In this case, I learned Kroger's ROE was only 1.41% in 2010. Even though, Kroger's ROE increased, the increase is volatile. A possible reason for this volatility could be fuel sales. Next, I calculated net operating profit after tax (NOPAT) by taking net operating profit before tax (NOPBT) minus tax on operating profit. NOPAT equals 1811. With NOPAT, I was able to calculate a very important ratio—return on net operating assets (RNOA). RNOA equaled 16.5% which breaks down to a net operating profit margin (NOPM) of 1.9% multiplied by net operating asset turnover (NOAT) of 8.3%. The industry average for NOPM is 6% meaning Kroger is below the average and does not produce profit as effectively as the industry. The industry average for NOAT is 1.4%; Kroger is above industry average implying Kroger is an efficient producer. The industry average debt to equity ratio is 1.5, and Kroger's is 2.1 which is not ideal. I also calculated the times interest earned ratio which equaled 5.98 which means Kroger is good at paying its debt. At the end of my analysis, I created a forecast model using two different models—discounted cash flows model and residual income model. Using the discounted cash flows models, I calculated that Kroger stock would be valued at 29.31 while being traded at 34.20. Using the residual income model, I calculated the stock value to be 47.08 while again being traded at 34.20. Through my analyses and valuation, I decided it would not be financially smart to invest in Kroger stock at this time.

### What I learned

I learned the true importance and significance of financial statement analysis and equity valuation. I have computed ratios and stock valuations individually various times; however, this was the first time I connected all the ratios and valuations together to come to a conclusion. Financial statement analysis and equity valuation are the key to determining the real value of a company in stock. It is also idea to do my own analyses of a company versus listening only to analyst's opinions or reading Forbes.

## *Ernst & Young, November 14, 2013*

- Jason Honeycutt – Tax Partner  
Memphis, TN
- Emily Edwards – Campus Recruiter  
Nashville, TN

### Summary of the case

Asbat Pharmaceuticals is a leader in the industry and has been in existence for 22 years. Asbat only operates in the US and has total assets of 3.5 million. In its early years, Asbat operated at a net loss; then, after its 5<sup>th</sup> year and release of its first drug, Asbat began reporting annual net profits. The profits continued until two years ago due to large costs in research and development. There were not any permanent tax differences in 2011, 2012, or 2013, and there is not any carry back available for the loss. Asbat has 100,000 common shares outstanding with no dilutive securities. The question is whether Asbat needs a valuation account; if so, what size valuation account?

### Our solution

My group worked through a professional judgment framework to come to a decision. We made sure to not make any bias or consider anyone's bias and consider the risk of material misstatement. We had to consider the involvement of others while maintaining professional skepticism. Then, we asked ourselves, "What is the primary issue?" The answer was does the company need a valuation account, and if so, determine how much. To gather the facts to answer our question, we had to determine what guidance we would use. We used the four sources of taxable income as guidance. Next we gathered previous financials, future forecasts, carry backs, tax returns, and temporary differences to address the issue. We could come to two different conclusions: 1) have a valuation account or 2) not have a valuation account. After our analysis, we concluded to create a full valuation account because the negatives outweighed the positives regarding a valuation account.

### What I learned

Broadly, I learned the professional accounting method to come to a conclusion. Similar to many other things in life, I constantly had to ask myself questions and question my own conclusions. Not every company needs a valuation account. It should be decided on a case by case basis by an analysis of the company and the industry. We also learned about deferred tax liabilities and deferred tax assets. Deferred tax liabilities increase the income tax expense, and the company eventually has to pay up. On the opposite hand, deferred tax assets decrease income tax expense and increase the amount of cash a company would have if they had to pay the income tax amount without the deferred tax asset. Regarding, DTAs and DTLs, both accounts have to be analyzed to ensure

realization on the balance sheet date and before the expiration. Also, we learned about carry backs and carry forwards. A company can carry back a net operating loss two years and carry it forward for twenty years.

## *Harbor View Advisors, November 21, 2013*

- Chris Haley  
Ponte Vedra Beach, Florida

### Summary of the case

We worked through a case about entrepreneurship and the steps to take if you have an idea and want to implement it into something successful.

### Our solution

The first step is to realize that the idea does not have to be new. Secondly, I would need to validate my idea by getting opinions from people I trust and advice from a consulting firm. Advice from a consulting firm would work best financially to have friends within social networks that I've gained through networking. In order for my idea to work, I would need drive, passion, networks. Most importantly, I would need luck and cash. Next, I have to develop my idea into an actual plan with a strategy, market, forecast, and meaning. I have to test that plan by getting feedback from potential customers, investors, and my network. Then, I have to commercial my idea-make customers believe they need it and it's worth it. The most important step is turning an idea into a successful entrepreneurial venture is growth. Not all growth is good because it is only possible to supply a fixed amount. I would need to find a happy medium where I am able to supply the demand. I must also scale my plan to a happy medium. Finally, I need to monetize my plan into cold, hard cash. Becoming monetized can be achieved my selling the company, go public, and continue operating off cash flows. All my decisions would be based on opportunity costs at the time.

### What I learned

One of the main things I learned is that accountants can have an extremely important role in entrepreneurial ventures. That role is a dual role with the business man. Accountants make systematic decisions based on rules and procedures while an entrepreneur is making their decisions based on their gut and drive to succeed. The two working together can create an amazing balance with an extremely successful outcome. As an accountant, it is very important to actually understand the business beyond simply reciting code. As far as entrepreneurial ventures, it is a very risky, unsystematic business. Some ideas succeed and others do not. It is as simple as that, but why? It all comes down to drive, passion, networking, LUCK AND CASH. Two people with very similar ideas can have total different outcomes. The business is unpredictable and takes two types of people to become successful. Accountants play a very important role in entrepreneurial ventures and will continue to do so.

## *FedEx, December 5, 2013*

- Janet Tarver – International Tax  
Memphis, TN
- Sylvia Ballard – International Tax  
Memphis, TN

### Summary of the case

For this case, I was a FedEx employee in charge of deciding transfer price methods for particular shipments. An automotive parts salvage yard decided to ship engines to customers via FedEx. I had to determine how to give the automotive parts salvage yard a price for shipping engines across the country.

### Our solution

First, I determined was that this shipment was actually possible and financially feasible. Shipping engines for salvage yards was very standard for FedEx; however, I did not know what method of pricing FedEx used for such shipments. Next, I had to read to remind myself that I must abide by an arm's length standard which basically means being unbiased. In other words, I cannot cut a deal to different companies for practically the same shipment. I decided that FedEx would use the transaction-based method Comparable Uncontrolled Price, CUP. I decided to use CUP for several reasons. First, CUP is a standard pricing method; therefore, it is easy to compute numbers and is widely recognized. Also, using CUP, it is imperative to compare pricing to other companies to get an idea of the correct price to charge. Lastly, CUP is generally for standard products meaning it is not intended for intangibles or secret objects. Ultimately, I determined FedEx can ship the engines and compute a price based upon the Comparable Uncontrolled Price method.

### What I learned

First, I learned that transfer pricing existed and was an extremely important subject. There are many points regarding transfer pricing, and some are mentioned in my solution to the case. Additionally, it is imperative that companies abide by transfer pricing because the penalties are hefty and differ among countries. Transfer pricing is important because it establishes prices and has an international use. There are three transaction-based transfer pricing methods—Comparable Uncontrolled Price, Resale Price, and Cost Plus. Additionally, there are three profit-based methods—Comparable Profits, Transactional Net Margin, and Profit Split. When determining which method to use, the degree of comparability between controlled and uncontrolled transactions and quality and completeness of underlying data and assumptions used in analysis must be considered. There is not a hierarchy of methods. There must be documentation as to why the particular method was chosen and why the other methods were not chosen. It is imperative to

have good documentation to support the method chosen because it is a penalty relief and cheaper than a possible IRS or foreign tax authority audit.